HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

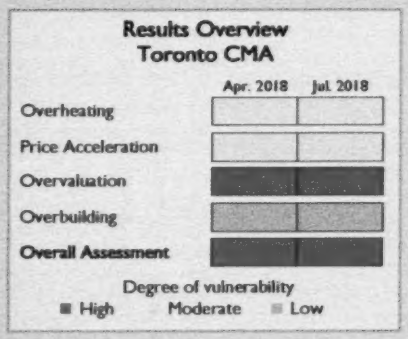
Greater Toronto Area

Date Released: Third Quarter 2018

Canada

CMHC SCHL

Highlights



- Recent results from the Housing Market Assessment indicated a high degree of market vulnerability in the Toronto CMA[1] housing market.
- We continued to detect moderate evidence of overheating and price acceleration, and strong evidence of overvaluation.
- We detected weak evidence of overbuilding, as the number of completed and unsold units reached a historic low.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

Colour codes indicate the level of evidence of problematic conditions. The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is from its historical average), and the persistence over time. Generally, low intensity and persistence are associated with potential weaker evidence of problematic conditions. As the number of intense and persistent signals increases, the associated evidence of problematic conditions becomes stronger.

In Detail

Overheating

We detected moderate evidence of overheating in Q1 2018. New regulations set by the Office of the Superintendent of Financial Institutions (OSFI) which came into effect on January 1st 2018, hampered home buying demand further with sales and new listings trending lower and resulting in the sales-to-new listings ratio (SNLR) reaching 47.8% in Q1 2018. Although the SNLR ratio was well below the threshold of 70% set to signal market overheating, the yellow (moderate) rating is maintained because the ratio was above the threshold for at least two quarters over the past three years.

In a bid to sell their homes prior to the new OSFI guidelines taking effect in 2018, sellers listed their homes resulting in the supply of new listings soaring to a record seasonally adjusted annual rate of 210,444 units in Q4 2017. In a similar manner, buyers brought forward their buying decisions and the number of sales trended up to reach 96,400 units in Q4 2017. The aftermath was a much cooler market in Q1 2018, with new listings declining significantly and sales reaching the lowest level in a quarter since Q3 2010. Interestingly, the market for condominium apartments during this period was quite hot, indicated by a seasonally adjusted SNLR of 71%, driven by a further shift in demand towards these relatively affordable units.

We continued to see less housing market activity in Q2 2018 as both seasonally adjusted sales and new listings trended lower. The seasonally adjusted SNLR during this period averaged at 47%. The condominium apartment market cooled down slightly as well, albeit still remaining tight, with a seasonally adjusted SNLR hovering around 61%.

Price Acceleration

We continued to detect moderate evidence of price acceleration in Q1 2018. The average MLS® price

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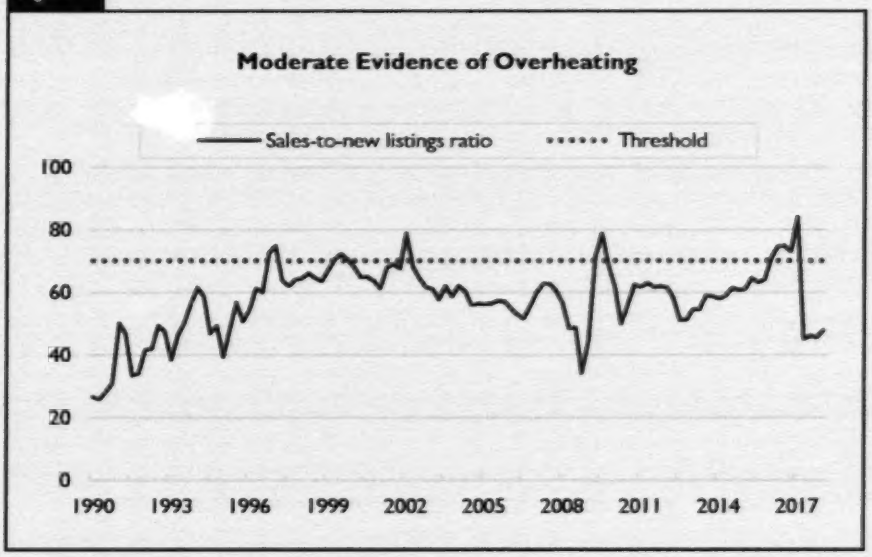
[1] Results are based on data as of the end of March 2018 and local market intelligence up to the end of June 2018. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

declined in Q1 2018 from the previous quarter mainly due to softening prices of single-detached homes – the housing type hardest hit by the rule changes. Despite price growth slowing down across the GTA, lower house prices would have to persist longer in order for us to discount any evidence of price acceleration. Therefore the rating from the previous quarter is maintained due to the persistence rule. Market conditions for condominium apartments have continued to remain tight thus resulting in stronger price growth for this housing type. Due to their weight in terms of dollar value, the drop in sales and decline in the average price of single-detached homes continued to weigh heavily on the overall average price.

In Q2 2018, the average MLS® price declined by 7% compared to the same time period last year, when prices were still relatively formidable. The growth in the average price of condominium apartments was 6%, while single-detached homes and row unit prices declined by 10% and 5% respectively. Recently, single-detached homes have seen their prices beginning to stabilize for the first time since the introduction of the Ontario Fair Housing Plan (OFHP) (see Figure 2). Conversely, price growth in condominium apartments continued following the introduction of the OFHP given their relative affordability and by extension, their popularity.

Figure 1

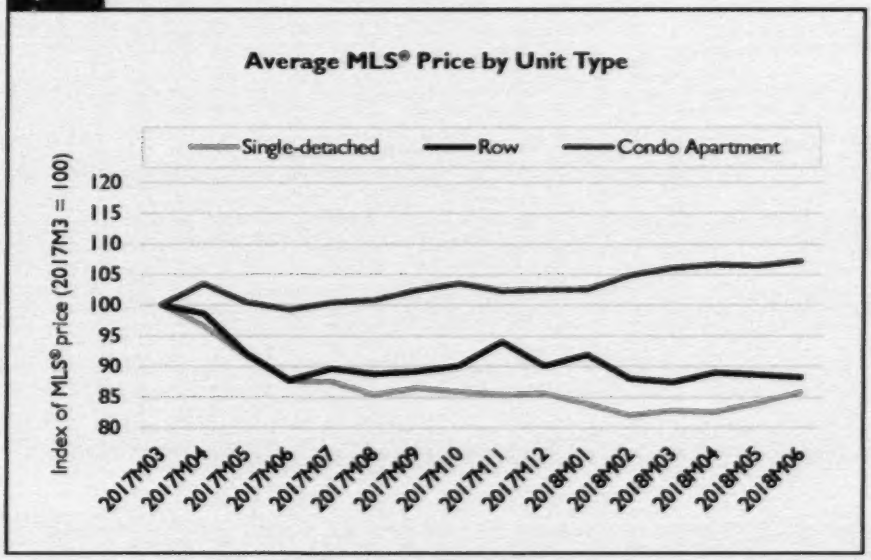


Sources: CREA and calculations (threshold) by CMHC
Last data point: 2018Q1

Dana Senagama, Principal, Market Analysis (GTA)

"Policy changes to the housing market over the past 12 months have dampened home buying demand and softened price growth. However, our assessment continues to indicate a high degree of vulnerability in the Toronto CMA housing market as price growth persists above rates justified by economic and demographic fundamentals such as income and population."

Figure 2



Sources: TREB and CMHC Calculations
Last data point: 2018M06

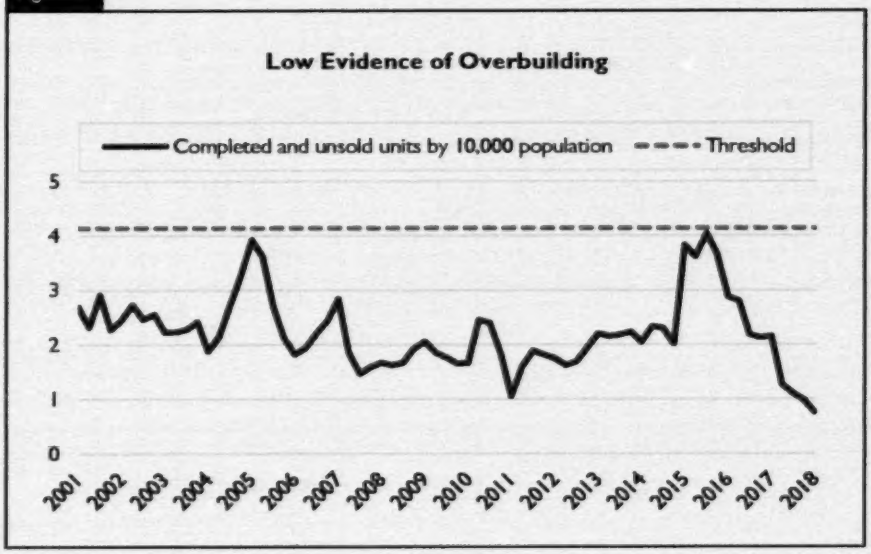
Overvaluation

We continued to detect high evidence of overvaluation in the Toronto CMA during Q1 2018. The gaps between average actual house prices and average price levels predicted by economic and demographic fundamentals went below the threshold set to signify overvaluation in Q1 2018, but due to its persistence above the threshold for the past 11 quarters, the red rating is maintained. A large contributing factor to the decline in overvaluation in Q1 2018 was the 13.2% year-over-year fall in the real average MLS® price. However, favourable growth in demographic fundamentals have played a significant role as well, where the growth in young adult population was 3.1%. More recently however, the labour market has shown some signs of weakening with seasonally adjusted total employment edging lower by 0.4% in Q2 2018 from the previous quarter and the unemployment rate increasing to over 6%.

Overbuilding

We continued to detect low evidence of overbuilding in Q1 2018, as the number of completed and unsold units declined further to 0.76 units per 10,000 population- the lowest level ever recorded and well below the threshold of 4.2 units required for evidence of overbuilding in the Toronto CMA. New home completions fell further during Q1 2018, providing an explanation for falling inventories in both low and high rise units. With nearly two thirds of the units currently under construction being condominium apartments, demand for these units remain high among both end-users (particularly first-time buyers) and investors. While most units are sold well before they reach the completion stage, units that are available for sale at the point of completion are quickly bought by buyers seeking this popular housing option. Supply constraints continue to curtail new construction of low rise homes thus resulting in lower inventories.

Figure 3



Sources: Statistics Canada and calculations (threshold) by CMHC
Last data point: 2018Q1

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (1) overheating (when demand outpaces supply); (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding (when the inventory of available housing units is elevated).

For each factor, the framework tests for: (1) the incidence of signs of vulnerability, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify signs of overheating, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers. The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed. To assess signs of overbuilding in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators that can identify imbalances. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators showing vulnerability from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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